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Regions Financial Corp. (RF)

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MANAGEMENT DISCUSSION SECTION

Gerard Cassidy
Analyst, RBC Capital Markets LLC

We'd like to get started with the final morning presentation. With us today is Regions. Many of you know Regions for a number of years. But to my immediate left is Dave Turner, who of course is the Chief Financial Officer of Regions, which has a market cap now of over $16 billion, assets of about $125 billion, over 1,400 branches spread throughout some of the faster growth states in our country, obviously Alabama, but Florida, Georgia, Tennessee, Texas. And so we're very pleased Regions has been one of the banks that's been coming to this conference going back probably over 15 years.

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

It's a long time.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

So, David, we really appreciate you coming. And to Dave's immediate left is Deron Smithy, who is the Regions Treasurer, and he joins us I think for the second year in a row. And then Amala Duggirala.

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

Duggirala.

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Amala Duggirala
Executive Vice President, Chief Information Officer, Regions Financial Corp.

Duggirala.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Thank you. We're talking about how I always mess up her name and she's – Amala is the Executive Vice President and Head of Operations and Technology at Regions Bank. So again, everyone, thank you for joining us. We appreciate your participation.

QUESTION AND ANSWER SECTION

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Maybe I'll start off with David. Obviously, we've seen a change in the rate environment over the last...

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

Five minutes?

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

...the last 12 to 18 months, and you guys have been very proactive in anticipating that. Can you give us an update on just, like you said, in the last five minutes, just how you're looking at rates as we go forward and into next year and how you've protected yourselves with some of the strategies you've implemented?

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

So let me start, then I'll let Deron talk about the details. So what's important is we do a rolling three-year strategic plan. And in 2017, we were looking at what was going to happen over the next three years. We knew there was going to come a time where we were not going to have leverage from rates. We knew the economy was going to slow. And with that was going to be a need for us to protect ourselves from a net interest income and margin standpoint.

So we have this wonderful deposit base that we think is our competitive advantage. It has another side to that sword, which is if our deposit costs are low and our peers are higher, they have come-down room to protect their income and margin, and we didn't. So we knew we were going to have to enter into some form of derivatives to help us do that. So we started a plan to add derivatives, primarily interest rate swaps and some floors. Deron will talk about the details, but we did that starting – forward-starting when they were cheap for 2020, with the theory that as the economy slowed in 2020 that the Fed would become more accommodative. So economically, we're exactly where we said we would be.

Where we missed it was that the Fed started to move into 2019, which caught us a little bit off. So we thought we were going to have two rate increases this year when we did our budget, June in December. Not only are we not

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getting the two, we got three, at least three thus far. So we're very thankful that the Treasury team, Deron leads that group of very talented people, and leads our ALCO [Asset/Liability Management Committee] process. And so won't you talk a little bit about the details of that?

M. Deron Smithy
Executive Vice President, Treasurer, Regions Financial Corp.

A

Sure. Actually, there are a lot of moving pieces, but our story when you boil it down is actually pretty simple. Through the hedging program that we've put in place, when 2020 starts we're fairly neutral to what the Fed does. And so fortunately, we don't have to try to predict what the Fed's going to do. The long end of the curve is still important to us and the shape of the curve, and that really primarily influences the rate at which new business that we'll be producing next year comes on the balance sheet. And so that's the residual exposure that we have.

We've been – since quarter end we've updated our disclosures. We've been trying to chip away at that since we've seen this nice backup in rates. So last night at dinner, I told the group that at current levels, last night's levels, it was roughly neutral. What was rolling off the balance sheet and what's rolling on was roughly a push today. We've pushed over $190 billion now for the 10-year, so it's a modest benefit to us. But we're on either side of a push, I would say, so within 10 basis points.

So the key takeaway from that is the impact of short rates not going to be a big driver of what happens to net interest income next year or the net interest margin. If we stay roughly at these levels, the balance sheet will reprice as we produce new loans, but that's not going to be a big driver either. If rates pushed below 180 basis points, call it down to 150, we do have some exposure as those new loans would come on at lower levels. We've been trying to chip away at that. We've hedged probably 30% of that exposure for 2020, somewhere in the 30% to 35% range. We'll continue to chip away with rates a little higher.

And what we're doing there is pretty simple. We're just very tactically locking in the rate at which – the forward rate at which those new loans will come on. And then the loans will come on in the future, we'll unwind the swaps and the gain and loss will go into the yield on the loans. So it's pretty straightforward, but doing that is reducing that downside exposure that if rates trade back down to 150 basis points that we would have a bigger challenge trying to grow NII from there.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

And similar to the earlier conversation, if there are questions from the audience, just please raise your hand. Speaking of loan growth, maybe you guys can give us some color where you're seeing some opportunities for growth. How is competition – are there crazy – I guess there are always crazy lenders. But are there more of them today than there were two years ago or three years ago?

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

Competition in our industry when you have 5,000 banks, you have 5,000 credit unions, and a bunch of FinTechs is intense. It's been intense and it's going to continue to stay that way and get worse. If you ask every CFO about irrational pricing, it's always going to be that other guy did it, you never did it. The truth of the matter is we all do things for our existing clients that we would never do for a new client because you know what the full relationship is. And so we're probably all guilty of doing irrational things from time to time.

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I will tell you we're cautious in this environment. We set ourselves up through our hedging program to not have to grow a lot going into what we believe to be a 1.8% GDP environment for 2020. We ought to be able to grow loans on a net basis, that's net of our runoff portfolio, at GDP plus a little bit, so not a ton of growth. That growth will be manifesting itself on the commercial corporate banking side, maybe a little bit of real estate price, probably pushing on the consumer kind of flat.

So I think that our clients are actually optimistic. They're being a little cautious with trade and tariffs and with Brexit and the election cycle. And all these kinds of things keep our customers from making that next dollar of fixed capital investment to grow because they're having – they had a good 2018. They're going to have a good 2019. 2020 is getting into the book already, and so they're not willing to take that risk. So we think loan growth will be a bit muted because of GDP. There are some that want to push through that, and we think that's going to be a mistake. We think over time that perhaps spreads can widen out because people have overextended themselves, and that's why we hold about $500 million of excess capital. We'll probably talk about that later on to be able to take advantage of opportunities should they arise.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

David, one of the areas that we've seen some real strong loan growth is the industry is lending into the private equity area. And I think if you look at banks over $10 billion in assets, earlier this year, in the first quarter, where $400 billion was lent into the private equity area. And you guys are not big players there. And your disclosures, by the way, I think many of us would agree are some of the best in terms of your loan breakdown. Can you share with us? Are there any concerns in the loans to the non-financial – I'm sorry, non-depository financials?

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

When you make loans to people that are loans that you wouldn't make, you answered your own question, and that's how we think about it. Now are there some projects that would be from would sponsor and we like that particular sponsored entity, that's what we're lending into. So to give people money to go do things we wouldn't do with our own money directly is idiocy.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Yeah.

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

So we stayed away from that. There are some good sponsors out there. Leveraged lending is – you see our leveraged lending disclosures. We don't have a lot of that. We have in particular as you define it, the way that the regulators do, about $2.5 billion.

So we're staying away from trying to stretch for that kind of growth. That's not who we are. We're a relationship bank. We're not trying to just grow the loan portfolio. And you can't make money lending money today very well. You have to have other things that come with that to make the relationship profitability, to get to the return. We have focused for the last several years on return on tangible common equity because it's the metric that's most closely correlated to our share price performance. We think that's what investors want. They don't want nominal growth of the balance sheet, nominal revenue growth, nor nominal net income. They want the right kind of growth that gives – that rewards the shareholders. So we're going to stick to that and not try to push.

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Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Maybe, do you have a question?

Q

[indiscernible] (00:10:35-10:48)

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

Sure. So the question was how do we, given this challenging revenue environment, how do we leverage our technology, in particular REGGIE and ROSIE? So REGGIE is in our context. So these are AI examples in our context, and ROSIE is the next best action that's guiding our customer service reps to help a customer fulfill a need. Amala, why don't you talk a little bit about what we've done?

Amala Duggirala
Executive Vice President, Chief Information Officer, Regions Financial Corp.

A

All right. And I think the intent of the question is our technology helping generate more leads in the digital channels and then out – is that fair to assume that that's the way the question was going?

Q

Actually a little more on the ROSIE side, but also I think on the expense side because [indiscernible] (00:11:30).

Amala Duggirala
Executive Vice President, Chief Information Officer, Regions Financial Corp.

A

Okay, perfect. And we are heavily using artificial intelligence and bots on operationalizing quite a bit of back office functions that are in the organization. On the ROSIE side, ROSIE is heavily primarily focused on lead generation, the next best action in our channels, whereas REGGIE on the back end side uses IBM's Watson to help assist our contact center agents as to what is the next action to talk to the customer. It's like a virtual assistant sitting in the back office. And I think so far, we have about several expenses we reduced in our contact center, a number of head count, which is part of our S&G number that we have already articulated.

And also what Watson is also doing behind the scenes is doing quite a bit of a machine learning and artificial intelligence so that we can do smart routing and we also know within the queue when the customer calls what can we do, can we take the customer off the queue by telling them we'll call you guys right back, so in that time we know of this issue. So there's quite a bit of efficiencies in development to do that.

Just coming to specific machine learning, we are applying machine learning and then data analytics in two areas. One is revenue generating and expenses. On the revenue generating side, we've also done something called [ph] R-click (00:12:47), which is to our RMs through aggregated data platforms. We actually provide our RMs their operational account if there's a risk to the operational account, if there is an opportunity within the operational account for another sale that we can make, or also if there is a sale that they didn't even make to this particular account that we actually can make. So that is another area that RMs used to take more than seven to eight hours to do that kind of research in preparation for these things. We actually send it to them every morning and say in

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your area these are seven accounts that you actually can focus on. So those are some of the examples where we are heavily using AI and machine learning on efficiencies and also as a revenue generating partner.

David Jackson Turner

Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

Also, the [ph] R-click (00:13:33) that Amala talked about is fairly new. We're excited about what it could bring to us in terms of solving a customer issue by helping a customer fill a need.

Your question came also from the expense side. And while we're happy that we leveraged some technology to help us there, I don't think we're near as far as we need to be on taking process improvement first and then leveraging the technology on whatever that new process is. Throughout the bank, whatever area you might be, including finance, I don't think we're where we need to be yet, which gives us some opportunity to hopefully continue to work towards a better efficiency ratio over time.

Gerard Cassidy

Analyst, RBC Capital Markets LLC

Q

Question?

Q

David, on your outlook for loan growth, while you've been very realistic, it's also a bit more downbeat than some of your peers on what we've heard in earnings through this morning. So is there something you have to flip-print, or maybe is it your loan portfolio that would necessarily have you have lower loan growth, or perhaps are some of the other management teams a bit more Pollyannaish than you all are?

David Jackson Turner

Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

I won't comment on the other teams, but I will say that part of ours is being careful on extending credit. So on the business side, we have our Corporate Banking group. We have Commercial Banking and Small Business, that's one segment, and we have Real Estate. Real Estate will get some growth. We probably have the second lowest real estate – I'm talking about investor real estate, concentration of any of our peers. We have some projects that we're looking at that we think we can get a little bit of growth, not a lot, but some. The commercial small business area is bread-and-butter. That's where we talk to clients a lot about what do you see in the economy, what are your needs going to be. And I think people are really cautious about that, and we don't want to force loan growth, we want it to happen naturally there.

The area that we can grow the fastest in and the easiest is in the Corporate Banking group, so these are large institutional clients. A lot of them are Shared National Credits, thin spread, profitability on our loan is not great, hard to make the math on the return work unless you can be relevant to that client and you can get Treasury Management and other services.

We've sought to improve our return in that area. And so we're asking that group really to recycle capital more so than grow, because growing means becoming eighth place in a syndication, where you don't even know the CEO or CFO. You're just not relevant. You've rented your balance sheet. That's not a good play for us. And so sometimes you have to do that because you have to get into a syndication, and then you have to work it over a couple of years to be more relevant. So we'll do some of that. But for the most part, it's really recycling capital. So you're not going to get growth from one of our largest areas. And I think that's a bit why we're probably less

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optimistic about net loan growth. But again, we don't have to have the kind of performance that we need to have for 2020.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

David, speaking of capital, maybe you can give us an update on your views on your CET1 ratio and what you may see for that over the next one to two years.

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

So I'll start and let Deron add to this. So our common equity Tier 1 target of 9.5% hasn't changed, so we finished last quarter at about 9.6%. That number will move to 9.4%, 9.6%. We'll be right around the hoop on 9.5%. Like our CECL number, which we changed our range to $500 million to $600 million versus $400 million to $600 million, so that will cost us, call it, 40 basis points, just around that. That will be phased in over four years, so 10 basis points. We need to see what the regime is going to look like from the regulators over time relative to CECL to see if the required capital numbers come down as a result of having a much larger reserve, don't know. If not, then we've just put more capital essentially into the system.

So 9.5% is our number today. That does have 50 basis points of management discretion. Our calculation is actually 9%, and we set that so we can protect our dividend even in a downturn. And so the 50 basis points is used to take advantage of opportunity should they arise. Oftentimes you can make more money when there are problems if you're careful. And so if we can get to our return hurdles with 50 basis points of extra denominator, that's not a big deal. Do you want to talk a little bit, Deron?

M. Deron Smithy
Executive Vice President, Treasurer, Regions Financial Corp.

A

Sure. So I would just echo the comments. The 50 basis points is there for us to use opportunistically, 9% is our quantitative target. But when we see opportunities to lean into growth that we think is accretive to achieving our overall growth, strategic, and return objectives, you should expect that we're going to find opportunities to grow faster, and we will be able to bring that capital level down closer to 9% over time. So again, it's dry powder to use opportunistically when we think the growth opportunities are there.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Yes, John?

Q

Can you just talk about your appetite for M&A? I know it's been a bit of a focus [indiscernible] (00:19:12) deals. And then just talk about on capital and opportunities there [indiscernible] (00:19:17-00:19:24).

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

So the question was – it was about three questions, but let's say I start, John. The first one is really how do we think about M&A, and the second part of that is how do we think about technology investment in connection with M&A. Did I get that right? Okay.

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So it's been interesting to see some no to low-premium deals over the past period of time.

We had obviously First Horizon and Iberia in our markets that got together on a no-premium deal. I think it causes us to think differently about it. We get a question of where do we want to participate in M&A, and we've said up to now that really we've got a lot going on, we don't really see doing that. The math doesn't work for us, and that's when the target was asking for a lot more than where we were trading. Our currency wasn't strong enough to really participate in that.

Now you start seeing no-premium deals and low-premium deals. That changes the calculus. But let's not get carried away with that because before you even get to that calculation, you've got to think about what is the strategic rationale for doing a deal to begin with. And for us, having more density in our existing markets would be a rationale. We look at targets, and we have our list we've been tracking forever and a day that we really look at the right side of the balance sheet. We want to know what type of customers, deposit customers you have. Do you have checking accounts? Do you have operating accounts of businesses or do you have a bunch of money market CDs and hot money? You need to answer that question and then go over to the left side. What kind of loan portfolio and how might that fit with who we are and what kind of growth might we get off that that's reasonable?

And then oh, by the way, if they have a deposit system, we'll talk about that in just a minute, that would be a nice [indiscernible] (21:15), a little something extra for all you LSU fans, that we have – that we look at that. And then we say now what's it going to cost us to get that. And at the end of the day, the no-premium, low-premium deals give you a little more leeway if you had made a misstep in judgment on something.

So I think the market is rewarding those deals. It's what we've seen over the last two. I think we could participate in something like that perhaps, but we're not running out trying to knock doors down. Right now we're all looking up and seeing what's really going on in the market.

From a technology standpoint, I think to John's point, we are going to replace our core deposit system over the next roughly five years, and Amala can talk about that if anybody wants to go deeper into that. It's not going to change our expense run rate. We've been planning for this; it didn't just happen yesterday. We've known this was coming. And if an acquisition can solve that problem, that's wonderful, but we will never use that as a reason why

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Gerard Cassidy Q
Analyst, RBC Capital Markets LLC

Was there another question, Ken?

Ken Usdin Q
Analyst, Jefferies LLC

I just wonder if you could just talk about loan growth and talk about credit quality has been very good, very stable, even in in the tough pockets, you haven't really said anything. In terms of this kind of up and down of a 1.8% GDP environment, is anything changing as you guys look out?

David Jackson Turner A
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

We really feel like credit quality still is relatively benign. There's some normalization in certain credit metrics that are happening. This particular – this last quarter we had about $500 million of migration into substandard. We had

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a $300 million reduction in special mentions, so really $200 billion net of criticized or classified increase. We had a reduction in non-performers, I think $77 million worth, Dana? Is that right, $77 million? And so charge-offs were 44 basis points, within our 40 to 50, and I think that – we still believe credit is okay.

You have an issue from time to time with the credit. There are certain industries we're watching closer than others, and I think energy would be one that you would naturally expect us to be watching closely. By the way, we did have the results of the Shared National Credit exam that are reflected in all those numbers in the third quarter, and that's really important because a lot of – some of that's energy related. And as I mentioned to people before, the way the rating works for Shared National Credit for energy is the total leverage inside of the company, it's not the senior secured piece on oil or gas in the ground, which is what we lend into. But the rating is one rating, and so anyway we expect a lot of that to be resolved in a fairly short period of time. Fast casual is another area we're having to watch fairly closely. Agriculture, because of trade, we're watching that as well.

The beauty about this is that we don't have any concentrations like we did pre-crisis. So we don't have any one thing that can really upset us. But we have to pay attention to certain of those segments. All in all, Ken, I think credit is actually in pretty decent shape.

Gerard Cassidy — Q
Analyst, RBC Capital Markets LLC

Maybe circling back to technology for a moment, Amala or David, we often hear from the big banks how much they're spending on technology. And the question you get from investors is how do the smaller regional banks or just regional banks compete? Can you share with us what metrics should we as investors look at, not just for Regions but for smaller banks other than the universal banks, that shows you that you are very competitive and here are the metrics to prove it or vice-versa? If we can't keep up, then we're going to have a problem. I don't know if you have any suggestions on what we all should be looking at to see who is actually fighting very well against the big banks.

Amala Duggirala — A
Executive Vice President, Chief Information Officer, Regions Financial Corp.

I'll start, and then, David, you can jump in. So I get asked that question many number of times compared to the big banks. Budget numbers is what we look at and say can you compete with the $10 billion spend versus $625 million spend. And I think Regions Bank is in a very, very sweet spot when it comes to that agility and flexibility that we have at this point of time. We do not have the complexity of any of those large banks at all. We do not have the scale to deal with the number of branches or the international regulations forces.

So I think the place where we are in, we do have a very simple architecture. We have one system. We have one core system. We have one brand system. Recently we did have an upgrade and we have already advanced a wealth platform, which we are in the cloud as of right now. We replaced about 12 systems to get to one single platform on the cloud for wealth. We upgraded our mobile online platforms completely to next generation. We have upgraded for the next four to five years of volume and the speed at which we need to move. And then you look at corporate systems, we are on a [indiscernible] (00:26:40) with loan origination systems.

So you name it, in every place we are clean, we are fast, we are agile, which kind of helps us and positions us in a unique spot. But when you're looking externally, what should you look for is when you're looking externally, what you really have to look for is the customer accolades and then look at the surveys, the Gallup surveys and things like that. What are our customers talking about? That's one way to look at. J.D. Power might be, [ph] Jacqueline (00:27:05), Gallup. When you look at those metrics, we're always the top quartile in those metrics. In some of the surveys, we are the number two in online in some surveys. And then in mortgage servicing and fulfillment, we're

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usually number one. And when we fall to number two, we actually lose to Quicken more than a peer bank. So our competition is [indiscernible] (00:27:28). So that's one variable I would always advise people to look at. What are our customers saying? Where do you stand with respect to your usage and all?

The number two thing you could look at is, are we providing our customer a choice in their banking? Are we forcing them to come to a branch, or are we actually provide them a multi-channel and an omni-channel approach? The choice in banking is the bank making investments into providing a customer a choice in their banking is the second aspect that one can look at.

And the third one is a question that has already been asked. Are they investing in the right technologies? Are their investments going into artificial intelligence, data analytics, robotics, efficiencies? Is the bank reinventing itself on a constant basis rather than sticking with the old practices? So I think that is the third thing you want to look at. Cloud maybe or upgrading the systems, what is the approach they are taking to upgrading their systems? Those are the things you'd want to look at, to observe if the bank is relevant or not. But as Regions Bank, we are in a very, very sweet spot to attend to our customer needs, in a speed and pace that is unmatched with any of our other peer banks as of right now.

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

Dana can tell me what page it's in, but it's in the deck that you're looking at that shows at the bottom a number of third-party results in terms of technology comparisons. That gives us some pretty good feedback. We look at every competitor and what they're doing. Clearly, we can't spend the kind of money that the money center guys can, but we've yet to see a competitive advantage as a result of technology that we can't copy quickly. What they have is a lot more money that they can put into marketing. And so that's important, in most of our markets we don't compete with a money center bank. We are the money center bank in the markets that we choose to operate in. And so that's why this density, getting back to M&A question, density in those markets make that market very, very valuable to you. So we have to continue to invest and stay on top of it because this is changing. But it's table stakes, it's not the competitive advantage.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Shifting to an area that we really haven't discussed much this morning, and it's not who you guys are all going to vote for, but if next year there is a change in the White House and a populist gets in, the question is when does a bank like your bank at the board level, when do you sit down and start to put some strategies on the table to discuss if there's a dramatic change in the political outcome come next November? The markets don't appear to be saying it will happen, but you never know. So it's more when do you guys – or can you plan for that kind of stuff?

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

Wow, I'm going to try to answer that and stay out of trouble, since this is taped. There are some things you just can't predict. I do think that we're in a very unique election cycle with different choices. We'll see what the Electoral College does to us, and I think those are things we don't try to anticipate just yet. Now, if something wild starts to happen, then it's incumbent upon us and our board to be thinking strategically about how to address whatever circumstances that exist at the time. But trying to anticipate that at this juncture I think would be, one, it would be a very painful exercise, but I just don't – I don't think any good can come out of that. You may make a

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decision, a bad decision there for an outcome that you predicted that didn't happen. And so we think that in the back or our minds we don't give it a lot of thought just yet.

Gerard Cassidy
Analyst, RBC Capital Markets LLC Q

Okay. Yes, Nancy?

Nancy A. Bush
Analyst, NAB Research, LLC Q

[indiscernible] (00:31:30-00:32:15)

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp. A

So the last part of that is no. So the question is would we stay in a market if it's not profitable because we feel compelled politically or otherwise to do that. We run our company to be profitable. We do have to take care of our communities and make investments back in our communities. It's incumbent upon us, it's part of our shared value. Shared value takes care of our associates, our customers, the communities in which we choose to operate, and our shareholders. All four of those we have to consider in all of our decision-making.

Our company is made up of some small markets, a lot of small markets and some growth markets. And it's that small market concept that has really helped us and the density we have in those markets to give us our competitive advantage, which is our deposit base. Two-thirds of those deposits are consumer deposits. Of those, half of them, 60% of those are customers that have been banking with us for over 10 years, so a very loyal customer base. As long as we continue to serve them like they want, we'll keep that, and that's really what is fuel for our growth in net interest income and liquidity.

So we understand certain of those markets aren't growing. They might even be shrinking, which is why we've made investments in some of our growth markets. So this past year, our investments included Atlanta and Houston, St. Louis, which is not a growth market but a big market and where we're positioned there on what we call the S-curve with that next dollar of investment actually is paying us back. And the fourth one is Orlando.

So what we're doing is we want to maintain control over those smaller markets. Whatever they turn out to be, make sure they're profitable, realign the network if we need to, which we've been doing over time, but make investments in some of the faster growing markets as well. We don't want too much of that because we're competing with a different bank when we go to Atlanta. And those are going to be more volatile and higher cost deposits for us, but we can use some of it.

Nancy A. Bush
Analyst, NAB Research, LLC Q

I have to say we already have deposit windows at the White House.

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp. A

Okay, there you go.

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Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

There you go. Okay, there you go. Good point. Another question that we have, coming back to interest rates, David, is there an environment that – what would really keep you up at night on a yield curve or things just go haywire somehow? What environment would that be for Regions, since you've done a real good job in planning for the current environment? But if there's a curve ball out there, what would it be?

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

It was originally rates. And we've done a good job, I think, of hedging and protecting ourselves in an ultra-low rate environment. As Deron mentioned earlier, the 10-year we have had a little bit of exposure, but we're taking care of that. Today's a good day to take care of even more. So I think it's economic output. We need the rest of the world to come along and get better and heal so that the economy can grow not at 1.8% but 2.8%. That would be wonderful.

The environment which I don't think is very probable but which would be difficult to deal with would be a negative interest rate environment. I think the Fed has come out said we're not going to let that happen because we don't see proof that that really made a positive difference. But that would be tough to deal with. We need – a flat yield curve is problematic, not just low rates but flat. If we can get low rates and a little bit of slope, we can make some money there.

And so it may be challenging, but I feel pretty good about 2020. We are committed to positive operating leverage in 2020. I was asked that two times I think back-to-back on the call, as if I made a mistake. So you can write it down, we're okay with that. We're not committing how much, but it will be challenging. Over the next three years, 2020 is going to be the most challenging on positive operating leverage because of the challenge with NII coming off of the first six months of 2019 having a much higher rate environment. So I think this could be a challenging year for our industry, but we think we've put a lot of things in place to really help us outperform.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

One of the areas that we have nice growth in the organization is on the investment banking side of the fee revenue. Can you give us some more? I think you mentioned obviously challenges at the net interest level, net interest revenue side. Can you share with us some of the growth that you might see in that line item?

David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

So non-interest revenue – so NII is 65% of our revenue, and that's going to be a challenge. We just committed to positive operating leverage. That means NIR really needs to come through along with controlling expense. So in NIR, we have five categories there. Service charges is number one. That really is driven by account growth, account meaning checking accounts and operating accounts. So that's why that is foundational, fundamental to who we are. You've got to get that if you want to succeed. We feel good about that.

Next would be check card, ATM fees, more accounts, more cards, the usage is going up. We all use more cards then every year. It's going up if you look at the Fed data. We're on a relative basis probably the largest debit card user in the country, on a relative basis.

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And the third category would be mortgage. Mortgage ought to have a pretty decent year next year with low rates. Capital markets; capital markets is – they've got four or five businesses within there. It's been a little bit challenged this year. We got off to a slow start in the first half – I mean first quarter with the government shutdown, but we think capital markets is going to have a good fourth quarter. We've talked about that being a $45 million to $55 million revenue business, call it $200 million a year. It's going to fall short of that, but I think that going forward we'll get the M&A piece going. We've got the Fannie Mae DUS program that will pick up for us. The derivative sales, that's probably going to be challenging and we got a CVA adjustment and there that's probably going to put a little challenge to us.

Syndications, loan syndication business doing okay. And then fixed income sales and trading, which we stood up, hired some really, really qualified people to help fund that piece of the business, could help us grow in capital markets. And the fifth one would be wealth management. Wealth management, we hired more wealth advisors. The market will stay at 18 times plus. We should be able to grow AUM and grow wealth nicely.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Marty?

Marty Mosby
Analyst, Vining Sparks IBG LP

Q

A bigger question, but I'm going to ask it anyway. If you think about selling to anybody, not that you're selling recent [indiscernible] (00:39:27), would you love to be a $25 billion bank or a $125 billion bank given the dynamics that we're seeing in the market right now? So not necessarily Regions, but it used to be if you were a $25 million to $35 million, you get a premium still, and it was a good place to get to. That may not still be the case, so I was just curious how you thought about that process

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David Jackson Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

So the question was if we were a seller, would you rather be a $25 billion bank or a $125 billion being given multiple differences? So early on, the multiples for the smaller banks were in the 20-plus range and the $125 billion banks weren't. They were substantially lower. I think the only benefit I see on size is that you have more people that can buy you at $25 billion versus if you're at $125 billion, no one but the money center guys are really out. There are only a handful of people that can really get together. That's the limitation you have when you're our size.

I think at the end of the day, it's incumbent upon us all to run our franchises appropriately and earn the right to be independent every day. And if you can't drive your car appropriately and get the returns to the shareholders, then somebody else gets to drive. That's that simple. We think we have a good strategic plan. We've been executing the plan. We've done what we said we were going to do. And as long as we can continue to do that, we are in control of our destiny, and we'll look for opportunities to help fill in, as I've discussed just a minute ago on our M&A discussion.

To the extent we run out of gas though and we've done all we can, then we would do something different and be part of another entity. We still have a really competitive deposit franchise we would do something different and be part of another entity. But we still have a really competitive deposit franchise. Not many people have what we have. Now it's more valuable when rates are going the other way than they are coming down. But nonetheless, of

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course, stable deposit base give us franchise value that people would love to have, but we want to leverage that ourselves and can do so.

Gerard Cassidy

Analyst, RBC Capital Markets LLC

We've run out of time. And please join me in a round of applause, thanking senior management from Regions. We have lunch in the room. So everybody's left for about an hour and then we start with KeyCorp right after lunch.

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